DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

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IN THE MATTER of NorthWestern Energy's December 2005 Electric Default Supply Procurement Plan	)))	UTILITY DIVISION DOCKET NO. N2005.12.172

COMMENTS OF THE MONTANA CONSUMER COUNSEL

In December, 2005, Northwestern Energy ("NWE") filed with the Public Service Commission ("Commission") its 2005 Default Supply Procurement Plan ("Plan"). On April 20, 2006 NWE filed with the Commission an Addendum to the Plan, and on April 28, 2006 NWE filed a Revised and Amended Addendum ("Addendum"). The Montana Consumer Counsel ("MCC") submits these comments on the Plan and the Addendum.

While the Plan filed in December, 2005 is a conceptual planning strategy document that does not define specific potential resources or proposed resource acquisitions and does not address any efforts that NWE has made to pursue the acquisition of such resources, the April Addendum proposes initial resource acquisitions through a live auction mechanism. The Addendum, like the Plan itself, does not identify specific potential resources, but implicitly assumes that, whatever they are, they will appear through the mechanism of the auction market.

The Plan

In its comments on the Company's previous resource plan, the Commission stated that "NWE needs to follow through from planning to resource acquisition." The Commission also indicated that it was time for NWE to more concretely assess proposed resource acquisitions, including long-term portfolios that deal with the expiration of the base load PPL contracts. While that expiration is now less than fourteen months off, the current Plan fails to carry out these directives, but again restricts itself to conceptual evaluation of theoretical portfolios based on projected assumptions that NWE acknowledges may change, resulting in a different ultimate mix of preferred resources. Again, all of the evaluation in the current plan pertains to hypothetical resources -- no specific proposed acquisitions are identified. Given this lack of any specific achievement to advance actual resource identification or acquisition, it is understandable why NWE now seeks to shift that responsibility to a "transparent" auction market, notwithstanding the fact that the supply side of the market is very highly concentrated and dominated by a single seller, PPL Montana.

Had NWE's default supply planning and resource acquisition process advanced as it should have from the time the Company acquired the utility and default supply responsibility, the Company and its customers would not be facing the empty cupboard now looming ahead. Unfortunately, NWE has not timely transformed its planning into practice. Planning in and of itself has no value; its value lies solely in its ability to inform and improve decision-making. Planning provides a framework for methodically evaluating alternatives with regard to their performance under alternative assumptions about the future, and to compare them on criteria of costs and benefits and risk. Planning thus provides information that is vital to informed choice. But, planning that is not actually used to improve choice provides no real benefit to consumers or society.

The Planning Process

There is a lengthy history in the utility industry of efforts to improve planning and decisions with regard to investments in generation and transmission, to avoid costly mistakes and risks and to provide a robust environment for supplying consumers with reliable and affordable electric power. For the Montana Power Company this process, Integrated Resource Planning ("IRP"), led to greatly improved demand forecasting, evaluation of demand-side resources, and comparisons of alternative generating technologies. It probably helped keep Montana Power from making some expensive mistakes by forcing it away from simple assumptions about demand growth and resource needs.

With the advent of generation deregulation and the sale of Montana Power Company's generating resources and then the sale of the utility to Northwestern Energy, Northwestern became the Default Supplier with, ostensibly, little assurance of its future load. It was expected to acquire power supplies on terms that would avoid any recurrence of stranded costs, and therefore that would be purchased from other parties for varying terms that would allow the Company to accommodate the loss of its customer base to competitive suppliers. The focus of planning shifted away from integrated resource planning to "default supply portfolio" planning, which in theory would help the Default Supplier acquire a portfolio of contracts and other resources that would hold down costs to default customers while keeping risk within acceptable bounds. This remains the focus today, despite the recognition that Default Supply will likely serve virtually all the residential and commercial loads of NWE for the foreseeable future.

Both of these processes, MPC's integrated resource planning and NWE's default supply portfolio planning, were developed into elaborate models designed to evaluate complex combinations of alternative resource mixes under a wide variety of future environments – economic conditions, load growth, fuel prices, weather and hydro conditions, environmental regulation, and others. The models and procedures, as well as the assumptions driving the models, were developed with extensive consultation with the Technical Advisory Committee and the Commission. The development of these planning tools should be seen as a success story.

However, the use of these tools has been another story. First, investment decisions at times take place in a constricted time frame, with limited time available for data collection and analysis. In such cases a complex planning and decision tool may not be useful; by the time it can operate the environment may have changed and the opportunities may have gone away. For example, this appears to have been the case with Montana Power's purchase of power from Basin Electric G&T, where the decision was made by a different group within management that had neither a commitment to the IRP nor the time to use it to evaluate an opportunity resource. Combined with NWE's current insistence on preapproval, the complex nature of the planning model and process may fatally compromise the utility's ability to seize opportunity resources for Default Supply when they appear.

Second, planning tools may point to investment decisions that cannot be made for financial or other reasons known only to management. This appears to be the position that Northwestern has been in from the time it acquired the utility. Northwestern's portfolio planning process has shown from the beginning that there was excessive risk in reliance on market purchases for a significant portion of its default supply needs. However, there has been only limited success at securing long term resources (notably the Judith Gap wind project and the Basin Creek IC gas plant in Butte), even though major contract expirations have been looming. Explanations by Northwestern range from financial exigencies connected with the bankruptcy; a claimed inability to rate base generation; and concerns that affiliated transactions (for example, development of the MFM plant by an unregulated subsidiary) would be frowned upon by the Commission. A likely contributing factor is an apparently cumbersome, excessively risk-averse, and untimely decision structure within the company under which key supply decisions must be referred to out of state management. Continued failure to proceed expeditiously has put the company in a clearly disadvantageous position, relying excessively on short-term market supplies and exposed to PPL Montana market power, excessive volatility and risk.

<u>Plan Execution</u>

When the last portfolio plan was developed, for submission in January 2004, the planning process was focused entirely on the share of default supply needs not served by the PPL Montana contract or other resources under Company control. The intent was to reduce exposure to market volatility for the remaining supply needs. The long-term analysis simply assumed that the PPL contracts would be replaced upon expiration but did not focus on how to replace them. When members of the Technical Advisory Committee pointed out the very large risk associated with the contract expiration, NWE responded that replacement of the PPL contracts would be the focus of the next plan.

Two years later, we have the December, 2005 portfolio plan and its addendum that now proposes to unload the supply acquisition function into an auction mode in a highly monopolized market. The company faces the expiration of 450 MW of supply contracts in July, 2007, now a seemingly impossible time frame for acquisition of new replacement resources, and faces an immediate need for bridging contracts for replacement power until such time as new long-term resources can be acquired or built. While there is hope that FERC will act to constrain PPL Montana's exercise of its monopoly power, that the Montana legislature will partially unwind the 1997 restructuring legislation that led to the sale of Montana Power's generating resources, and that the just-announced purchaser of Northwestern, Babcock Brown Infrastructure, will eventually provide financing for generation resource expansion, there is no indication in the current Plan that the problems that have made resource decisions so difficult in the past will be rectified. If FERC issues a decision to strip PPL Montana of its market-based rate authority, the current crisis may, for the time, be resolved expeditiously. Longer term, the legislature may pass legislation that will clarify Northwestern's authority to build, own, and rate-base generation, and BBI, assuming the purchase passes regulatory and shareholder approval, may bring improved credit ratings and access to capital.

Hope, however, is a thin basis for assuring consumers of reliable, reasonably priced electric power, and if decisions had been made in a timely manner in the past, consumers' well-being would not now rest on hope. The current situation makes it clear that there needs to be a way to ensure that Northwestern's portfolio planning model results not only in seemingly elegant plans but also in timely and reasonable decisions and resource acquisitions. Otherwise, the planning effort is a waste of everyone's time.

Generic resources in the plan.

The use of generic resources to evaluate alternatives makes sense only if the generic resources are used as proxies for resources that could be built or acquired by the utility, and, if the planning process is at an early enough stage, that generic resources could be turned into actual resources in a manner that is timely with respect to need. The Northwest Planning and Conservation Council uses generic resources to model the future of regional power supply, but it does not plan in order to build, rather to provide indicative advice to BPA and to the region's policy makers and utilities. Northwestern used the Council's cost estimates for its generic resource analysis.

If the utility is planning to use RFPs to acquire resources, then generic cost data may be irrelevant if they bear little or no relation to bid prices. It is conceivable that in some cases the analysis of generic resources could allow bounds to be set on the relative prices at which different types of resources (e.g., baseload coal vs. dispatchable gas) are or are not worth pursuing, but there is little indication that Northwestern has structured its analysis for that purpose.

If this planning is to be of any value at all, it is time for NWE to begin making acquisitions of long-term resources consistent with the results of its plan. Although it will be forced to do so by circumstances of necessity, of course, NWE should exert maximum efforts to get reasonably priced contracts from the monopoly supplier, PPL Montana, and to the extent that PPL Montana continues to exercise monopoly power, NWE may well have damage claims and refund rights that it should retain. NWE cannot simply wait for FERC or the Montana Legislature to solve its problems.

DSM in the Plan

The targeted DSM acquisition in the portfolio plan ramps up by the third year to 5 aMW per year for 20 years, to achieve a total resource of approximately 100 aMW by the end of the 20 year period. This value is derived from a KEMA analysis of the total amount of cost-effective conservation achievable given the estimated energy use and appliance and housing stock of Northwestern's customers, assuming that Northwestern paid 100 percent of the program costs.

KEMA's analysis called for early acquisition of the full amount of achievable conservation, at considerable cost. Northwestern modified the KEMA analysis, stretching out the acquisition over a 20 year period, and assuming (based upon its experience) that it could acquire the full amount of conservation without paying 100 percent of the costs. The targeted annual conservation acquisitions are thus based upon untested assumptions and must be viewed with skepticism and be subject to annual verification of both costs and quantities. Until there has been some reassurance of the targeted acquisition rates, the portfolio analysis should provide for alternative supplies if the targeted conservation does not materialize. This is more than a matter of good planning, since Northwestern is asking for lost revenues based upon its targeted conservation. Northwestern should re-evaluate the effect of its incentive payments upon penetration rates and adjust the estimated amount of DSM savings that will accrue over the planning period.

The Addendum

The Addendum to NWE's 2005 Default Electricity Supply Resource Procurement Plan proposes the use of a two stage live auction process to acquire generation resource needs with a term of five years of less. The first stage, which NWE has referred to as a "pilot" auction, would be conducted during June, 2006, and the second stage would be conducted in the fall. According to NWE, "Up front acceptance [i.e., a finding of "prudence"] of the utilization of the auction process by the MPSC is required…."

MCC has major concerns both as to the auction process proposed and to the advance determination of prudence requested by NWE. Auctions are market procedures that depend upon competition between bidders to determine market price. The ability of any auction to achieve a competitive price depends crucially on adequate supply alternatives and the availability of excess capacity. When capacity is short and supply concentration is at the extremely elevated level that now exists in Montana, it would be unwarranted to assume that an auction, no matter how artfully designed, would produce a competitive market result.

In contrast to any expectation that the outcome from the proposed auction procurement process will be a competitively derived market price, the outcome will be a monopoly market price, and one which will severely increase rates charged to consumers. As the Commission is well aware, the generation resource supply market in Montana is far from competitive. One company, PPL Montana, owns and controls nearly all of the available generation resources in the NWE transmission control area (and is demanding large unregulated price increases and threatening refusals to sell, if it does not get its price), and available import capacity into the area is so limited that outside supplies, even if available, could not impose competitive discipline. Moreover, nearly all of the other electric utilities in the Northwest, including all of those with generation resources in Montana, are capacity deficient and cannot be expected to provide firm generation alternatives in any event. MCC, as well as the Commission Staff and even NWE, have reported these prevailing conditions to the Federal Energy Regulatory Commission (FERC) and have asked the FERC to withdraw PPL Montana's market rate authority and impose cost-of-service rate requirements until such time as workably competitive generation supply markets come about. An Emergency Motion for Expedited Decision on this matter has been filed and FERC hopefully will act accordingly within a short period of time.

Given the absence of competitive supply conditions in the Montana generation market, it is virtually certain that market prices resulting from NWE's contemplated auction process will not be competitive prices. They will be prices that are the product of PPL Montana's generation market monopoly, restricted import capability and the absence of any firm base load generation excess anywhere in the Northwest. Under these circumstances, the certain result of NWE's auction proposal will be much higher generation resource costs and much higher rates to consumers than those that exist now or that would exist in a competitive market. This is not an end-result tolerable to Montana consumers nor one for which the Commission should give advance approval or an advance prudence finding. It is the responsibility of utility management to act prudently to get reasonably attainable power supply and of regulatory commissions to oversee this process. These functions are inappropriately shifted when commissions approve utility decision-making in advance without knowing all the input factors or the results of decisions to be made. Whether accepting bid prices will be prudent depends, at least, on what those prices will be and the reasonably perceived alternatives at the time.

As discussed above, there is no doubt that time has now grown exceedingly short before NWE's base load default supply contracts expire. That NWE's effort to procure renewal or replacement of these supplies has lagged is likewise undeniable. There is little doubt that this effort, at least for a time, was complicated by NWE's bankruptcy and, more generally, by PPL Montana's consistent efforts to exert and perpetuate its monopoly power by opposing whatever efforts were made to elicit alternative supply options. Nonetheless, there are better options than abandoning default supply procurement to the fate of an auction in a non-competitive market. NWE, as the aggregator and wholesale buyer for nearly all retail and commercial electric power demands in its control area, has responsibility for the hands-on pursuit of the best attainable wholesale supply solutions for its captive retail customers.

The notion that Montana's electricity supply needs will be reasonably provided by competitive market forces is unsupportable. There is no competitive electric supply market available in or to Montana and it would be unreasonable for the Commission to give advance approval and a finding of prudence to a resource procurement plan premised on such imagined existence. It would be equally unreasonable to allow NWE, which has been granted the right and obligation to acquire wholesale supplies on behalf of all default supply customers, to minimize its own corporate risk by abandoning default supply responsibility to the results of a "transparent" auction in a one-supplier dominated market.

NWE's filing in support of such a plan claims that it would produce a "transparent process that is more easily explainable," one that "is methodical and systematic and thus removes the utility from the position of trying to predict the market," and one that can be easily implemented in a short time frame. While these "merits" may all serve to shift corporate responsibility for the end result, what is missing is any basis for believing that the end result will be fair rates for Montana consumers. Rather than setting up an auction process as a corporate protective procedure to produce pre-approved market results in a noncompetitive supply market, it is now high time for the designated default supplier to assume the responsibility and use the supply procurement abilities that it has or should have to negotiate and bring forward cost-reflective default supply options. Transparent and methodical market systems might work if we had a competitive supply market. Now, however, we need an empowered wholesale buyer that is able and knows how to use its supply aggregator capabilities to negotiate some good cost-reflective deals that will be fair to consumers.

Respectfully submitted May 5, 2006.

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